CIA/OER/IM 71-2 SOVIET AID IN INDIA'S DEVELOPMENT

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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Declining Role Of Soviet Aid In India's Development Program

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INTELLIGENCE MEMORANDUM

The Declining Role Of Soviet Aid In India's Development Program

Introduction

The Soviet-Indian aid relationship has become strained. India finds itself unable to use previously extended Soviet credits for heavy industrial plants, and its major Soviet-aided installations operate below capacity. India's failure to use Soviet credits more fully is a direct consequence of the reduced emphasis on heavy industrial expansion. It also is a reflection of Soviet inability to provide the technology required for specialized industrial plants India now prefers to build and of Moscow's refusal to allow the diversion of outstanding credits to purchase industrial raw materials and component parts. Drawings on Soviet credits have declined, while repayments are rising, imposing a considerable burden on Indian resources. This memorandum assesses the current status of Soviet economic aid to India and suggests probable trends during the remaining years of the Indian Fourth Five Year Plan, which ends in 1974.

Soviet Economic Aid to India

1. India has received more Soviet aid (in terms of both commitments and deliveries) than any other

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Third World country. Since its first credits in 1955 for building the Bhilai steel mill, the USSR has extended a total of $1.6 billion of economic assistance to India, about 55% of which had been delivered by the end of 1969 (see Table 1 and Figure 1). Almost all of this aid was allocated for public sector projects included in India's development plans -- approximately $650 million for the Second and Third Five Year Plans (1 April 1956-31 March 1966) and $555 million for the Fourth Plan (1 April 1969-31 March 1974*). In addition to aid under the five-year plans, $225 million in credits were made available in 1965 for the first stage of the Bokaro steel mill.

2. About two-thirds of total Soviet aid to India has been earmarked for heavy industrial projects (see Table 2). The steel industry is the chief recipient, the other important industries being heavy machine building, electric power, and petroleum. These projects, built during India's Second and Third Plans, have contributed substantially to the growth in India's production of steel, petroleum, and capital goods. Soviet aid projects account for 30% of India's steel production capacity, 50% of its annual output of crude oil, 35% of its oil refinery output, 60% of its electrical equipment production, and 80% of its heavy machine building capacity.

3. Deliveries under Soviet credits rose rapidly during the early years and averaged more than $100 million a year during 1963-65 (see Table 1). They dropped by one-fourth in 1966, however, and by 1967, had fallen to $50 million. Although deliveries averaged nearly $80 million during 1968-69, they still were about one-third below the peak years of the mid-1960s.

4. The year 1966 also marked the beginning of a sharp acceleration in India's debt service

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* *The Fourth Plan originally was scheduled for 1 April 1966-31 March 1971. Annual plans were introduced for 1966 - 1969, however, and the Fourth Plan was deferred until 1 April 1969 - 31 March 1974. The figure for assistance to the Fourth Plan includes $222 million of non-project aid.*

Table 1

Soviet Economic Aid to India Extended and Drawn

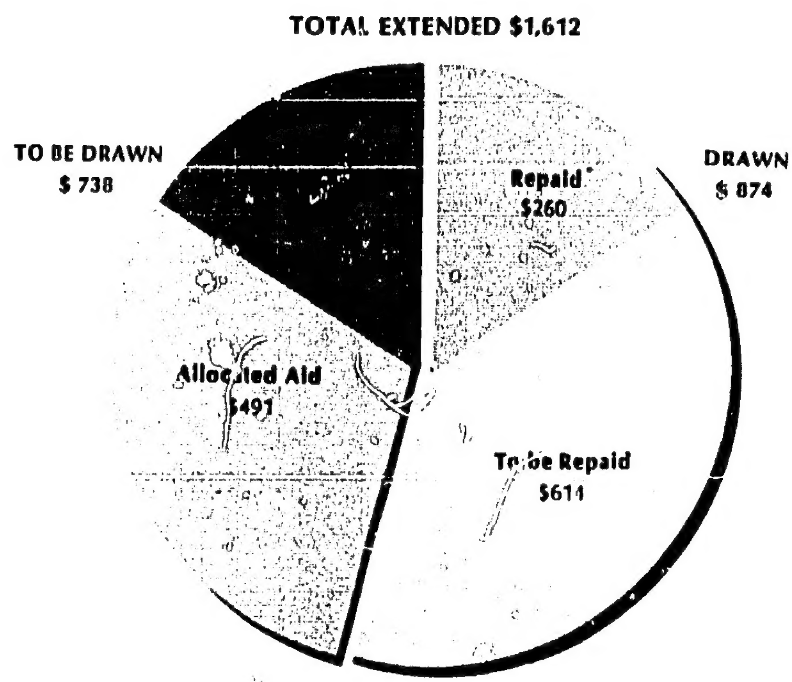
Million US $

	Extended	Drawn
Total	*1,612*	*874*
1955-60	686	159
1961	125	37
1962	-	46
1963	-	102
1964	-	126
1965	227	114
1966	574	84
1967	-	50
1968	-	76
1969	-	80

FIGURE 1

SOVIET ECONOMIC AID TO INDIA

1955-1969
Million US $



*Principal only

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Table 2

Industrial Allocation of Soviet
Economic Aid to India
1955-69

	Million US $	Percent of Total
Total	*1,612*	*100.0*
Steel mills	571	35.4
Bhilai	285	17.7
Bokaro	286	17.7
Heavy machinery plants	132	8.2
Ranchi	54	3.3
Durgapur	29	1.8
Hardwar	49	3.1
Powerplants	116	7.2
Neyveli	47	2.9
Singraul	31	1.9
Korba	24	1.5
Bhakra	14	0.9
Petroleum development	104	6.5
Petroleum refineries	55	3.4
Barauni	36	2.2
Koyali	19	1.2
Non-project aid a/	239	14.8
Other uses	148	9.2
Unallocated aid	247	15.3

a. Including trade credits of $222.2 million, extended in 1966, and $17 million in grants for food.

obligations to the USSR. Repayments of principal and interest for economic aid, which had been rising gradually, jumped from $28 million in 1965 to $44 million in 1966 and to $70 million in 1969 (see Table 3). The net inflow of Soviet aid from 1965 to 1966 was reduced by one-half and in 1967, repayments exceeded the value of aid delivered. There was a small net inflow of aid during 1968-69 (see Figure 2), but we expect a net outflow in the early 1970s. Repayments are scheduled to rise while, for reasons explained below, drawings may fall.

Cutbacks in Indian Investment

5. The sharp reduction in Soviet aid deliveries that began in 1966 reflected the repercussions of the 1965-66 crop failures on Indian industrial development. These crop failures pushed up the prices of agricultural products while reducing local demand for industrial products. At the same time a drop in exports and an increase in imports of agricultural products created a severe foreign exchange shortage, forcing the Indian government not only to hold down industrial imports but also to use more of its foreign exchange to buy fertilizer and other inputs for agriculture. To save foreign exchange and fight inflation, public investment was cut back, especially in heavy industry. Major capital projects were deferred and work on plants already under way was stopped or slowed, resulting in a 40% drop in India's imports of capital goods to less than $510 million in 1967. Because of the concentration of Soviet aid in public sector heavy industrial projects, imports of capital goods from the USSR were hit even harder -- declining almost 60% during those years. Except for the Bokaro steel mill, no new major Soviet projects have been initiated since 1966, and construction of plants previously undertaken has slowed.

Growing Unused Industrial Capacity

6. The sharp drop in industrial investment, while forcing a cut in imports of capital goods, also caused a decline in demand for domestic heavy industrial output. The expansion of Indian industries such as steel and machinery had been geared to the expectation that the rate of investment

Table 3

Net Capital Flow Under Soviet Economic Aid to India

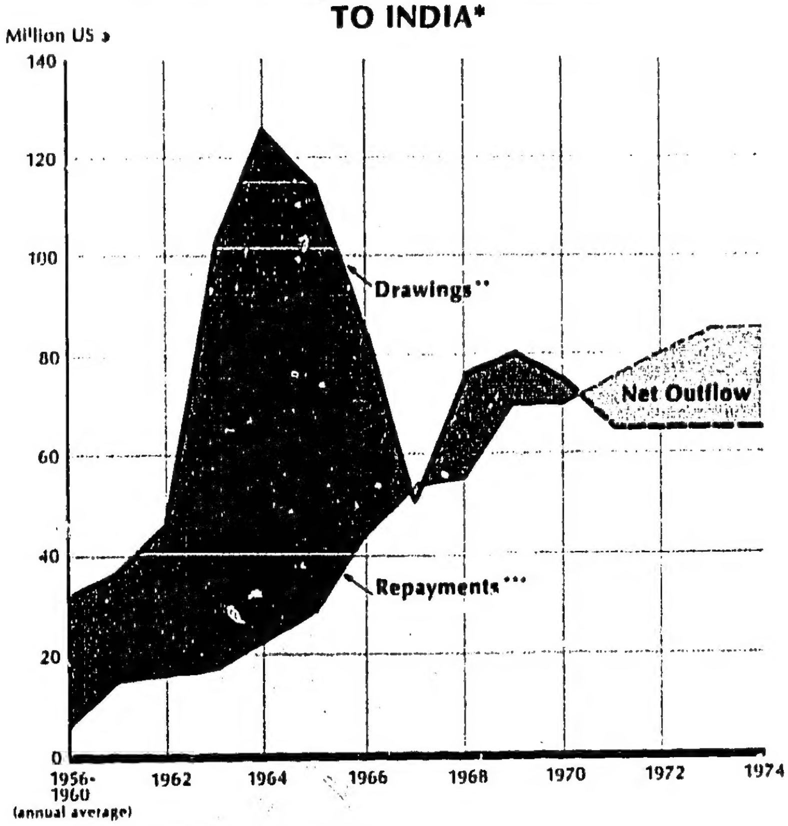
Million US $

	Drawings	Repayments a/	Net Flow
1956-60	159	29	130
1961	37	15	22
1962	46	16	30
1963	102	17	85
1964	126	23	103
1965	114	28	86
1966	84	44	40
1967	50	53	-3
1968	76	55	21
1969	80	70	10

a. *Principal and interest.*

FIGURE 2

NET FLOW OF SOVIET ECONOMIC AID TO INDIA*



*Data for 1970-1974 are estimated
**Includes project and non-project aid
***Includes principal and interest

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would rise sharply and continuously. When instead investment fell, a great deal of productive capacity lay idle. The problem was complicated by the disruptive impact of shifts in investment priorities. The Indians were able to expand exports of steel and machinery, but not nearly enough to make up for the drop in domestic demand. In 1969, some $1.3 billion of capital assets in India's public sector -- about 40% of its total publicly owned industrial plant -- still was not being used.

7. For several major Soviet-aided plants, the rate of unused capacity was even higher. In fiscal year 1969, such plants as the Bhilai Steel Mill, the Heavy Machine Building Plant at Ranchi, the Mining and Allied Machine Plant at Durgapur, and the Heavy Electrical Machinery Plant at Hardwar -- which together account for almost 50% of Soviet aid delivered to India -- were operating at the rates indicated in Table .. It is estimated that the equivalent of about $250 million of the capital assets of these four plants will not be used during the Fourth Plan. The plant at Ranchi has no orders beyond those for supplying equipment for the second stage of Bokaro, and operations at Durgapur are at such a low level that India has contemplated its temporary closure.

8. Although private sector steel plants operated near capacity during fiscal year 1968, those in the public sector still had sizable unused capacity. The latter plants have been plagued by planning errors as well as by continuing labor-management problems. Almost from the beginning, Bhilai was the victim of a failure to relate productive capacity to potential demand for specific kinds of steel and of premature expansion. The demand for Bhilai's output was affected further by the general slackening of demand for steel during the recession in 1966. Although the use of Bhilai's capacity has increased, it is still sufficiently low to be a principal cause of operating losses of about $8 million on 1970 production.

Table 4

Output-Capacity Ratios for Selected Soviet-Aided Plants Fiscal Year 1969

	Rated Capacity	1969 Output	Output as a Percent of Capacity
Bhilai Steel Mill (Tons)	2,500,000	1,771,673	71
Heavy Machine Plant, Ranchi (Tons)	80,000	23,852	30
Coal Machinery Plant, Durgapur (Tons)	45,000	4,099	9
Heavy Electrical Machinery Plant, Hardwar	Equipment capacity equal to 3,215,000 kw	N.A.	50 a/

a. *Estimate for fiscal year 1972.*

India's Revised Fourth Plan and Soviet Aid

9. As a result of the general economic recovery in India which followed an upsurge of agricultural output beginning in 1967-68, industrial production rose 6% in 1968 and nearly 7% in 1969. India's trade deficit narrowed substantially in 1968 and its foreign exchange reserves rose. Nevertheless, continuing tight fiscal and monetary controls, political uncertainties, and reduced dependence of the Fourth Plan on external capital have all contributed to a continued decline in investment and capital goods imports in 1969.

10. During its Fourth Plan, India hopes to improve the efficiency and increase the production of existing plants and to bring better balance to its industrial structure. The plan calls for an

increase in outlays for industry and minerals of about 90% over the Third Plan, mostly for completion of projects already under way. New public investment is being confined largely to high-priority areas where shortages exist, such as special steels, copper, aluminum, petrochemicals, and fertilizers -- industries in which the USSR is not technologically advanced. Soviet aid is expected to account for no more than 1.5% of total investment in the public sector, compared with about 4% in the Third Plan. Reflecting the Fourth Plan's emphasis on the use of existing capacity before adding new plant, only $13 million was allocated for public sector heavy engineering plants -- one of the principal areas of Soviet aid. On the other hand, investments totaling $240 million are planned for fertilizer and chemical plants. India's budget for fiscal year 1970 provided only $2.6 million for heavy machinery and engineering industries, compared with $73.3 million in fiscal year 1965. Planned outlays for the chemical and fertilizer industries are to rise from $8.3 million in fiscal year 1965 to $62.2 million in fiscal year 1970.

11. India's investment policy in the Fourth Plan will almost certainly bring a further cut in deliveries of Soviet project aid. Project aid deliveries probably will not average much more than $50 million a year, compared with more than $100 million during 1964-66. Given the large size of Soviet credits still outstanding, this raises the question of how else to expedite the utilization of these credits.

<u>Policy Issues for India and the USSR</u>

12. Although domestic economic difficulties in India during 1966-68 were responsible for the initial Indian action in cutting back Soviet aid deliveries, the problem of using all of the Soviet aid had concerned Indian planners even earlier.

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Accordingly, Indian ministers have pressed for the reallocation of outstanding Soviet credits to non-project use. Moscow has been unwilling to do this although it has extended non-project aid to India on harder terms. The USSR also has expressed concern over the Indian inability to use Soviet-aided plants effectively. During discussions between Soviet and Indian officials in December 1968, Moscow dropped some veiled threats concerning future Soviet aid if the Indians did not begin to come to grips with the inefficient operations of its Soviet-aided heavy industrial plants. In an effort to increase the output of these plants, the USSR agreed to import some of their products. The Soviet purchase of 600,000 tons of steel rails during 1968-70 is an example. The USSR also agreed to try to use the output of Indian plants in its aid projects in other Third World countries.

13. In addition to about $265 million of project aid that remains to be drawn for plants under way or scheduled for construction, India has not found mutually agreeable projects to allocate about $250 million of other Soviet credits. These unallocated credits include $100 million of aid extended for India's Second and Third Five Year Plans and $150 million extended for the Fourth Plan.* Indeed the revised Fourth Plan eliminated four plants originally provided for under the 1966 Soviet credits -- a refractories plant, a pump and compressor plant, a precision instruments plant, and a steel foundry -- for which no substitutes have yet been found.

* *If a refinery project (which India requires, but lacks the local input to undertake) were included under Fourth Plan credits, this amount would be reduced by about $50 million.*

14. Western economic assistance to India in recent years has been confined almost entirely to financing current commodity inports, such as raw materials and components. In fiscal year 1968, non-project aid made up about 85% of total Western consortium aid to India of some $1 billion. India has repeatedly asked that Soviet credits be diverted to similar use, especially for industrial raw materials such as nonferrous metals and for fertilizers, but the USSR has refused. Although the Indians are importing some fertilizers, zinc, plant components, and spare parts from the USSR, all of them are paid for either in cash, within the framework of the trade agreement between the two countries, or under deferred payment terms outside the aid credits for the Fourth Plan.* The problem of using Soviet credits was discussed in May 1970, but only a vague agreement to apply these surplus credits to mutually agreed projects, presumably light industrial plants, was announced. It is unlikely that India can use all of these credits, even for light industrial projects, during the little more than three years remaining of its current plan. Consequently, total Indian drawings on Soviet credits (project and non-project) are unlikely to rise from the current level.

Conclusions

15. India's economic problems of recent years have hit the implementation of Soviet aid projects particularly hard. A sharp cutback in heavy industrial investment greatly reduced both deliveries of Soviet-financed capital goods imports -- especially for the steel and heavy machinery industries -- and the utilization of productive capacity in existing Soviet-built capital goods plants. Utilization of Soviet project aid probably will continue to be slow through India's Fourth Five Year Plan begun in April 1969, which emphasizes the kinds of projects the USSR cannot handle well, such as petrochemicals, special steels, and fertilizers.

16. The USSR may provide some additional technical assistance in Soviet-aided plants to raise the low level of productivity. It may also help these

* *Under trade credits of $222 million extended in 1966.*

plants use some of their idle capacity by purchasing output that it can use in the USSR, such as the 600,000 tons of steel rails it agreed to purchase from Bhilai during 1968-70. The USSR also will try to use Indian-produced capital goods for Soviet-aided projects in other Third World countries. Nevertheless, the outlook over the next several years is for continuing idle capacity in a number of large Soviet-assisted installations, reduced Soviet project deliveries, and no new major plant construction.

17. The probable drop in project aid deliveries and the USSR's unwillingness to substitute commodity aid for project aid are likely to keep total Soviet aid deliveries at or below recent levels. With repayment obligations continuing to grow there will probably be a net outflow of Indian resources on Soviet aid account.